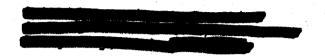
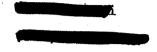
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Employer Identification Number: Key District:

Dear Taxpayer:

This is in response to your Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal

You were incorporated housing for low-income elderly persons. You have created low-income housing through the conversion of a defunct hospital formerly owned by the structure with a combination of local and rehabilitation of the structure with a combination of local and federal grants, tax-exempt financing and the sale of low-income housing tax credits. Pursuant to the tax-credit allocation, 95 of the 96 units in the facility must be occupied by persons whose incomes are 60 percent or less of the area's median income. Also, because the facility was allocated these tax credits, the units must also be rent-restricted as provided in section 42(g)(2) of the Code.

To utilize these credits you have entered into a limited partnership with an investment fund set up to invest in low-income housing projects acquiring tax credits for its investors. The respective rights and duties of the partners are set forth in a series of agreements including, without limitation, a limited partnership agreement, a tax credit guaranty agreement, a completion guaranty agreement, and a lease-up guaranty agreement

In addition to naming you as the sole managing partner, the partnership agreement gives the limited partner various controls over the operation of the partnership or control over the general

partner to ensure the protection of the limited partner. In order of appearance, the limited partner may exercise rights of control.

- 1. Section 2.9 the choice of the builder.
- 2. Section 2.33 the selection of the inspecting architect.
- 3. Sections 4.5 and 4.6 withdrawals from a capital reserve and a replacement reserve.
- 4. Section 5.7 without general partner concurrence, to amend the partnership agreement (on matters that do not affect the basic substance of the agreement or the rights of the general partner); to order the sale of all or substantially all of the partnership assets; removes the general partner with or without cause.
- 5. Section 6.3 to hire or fire any management agents including the property manager.
- 6. Section 7.3 to approve the maximum management fee as well as the sustance of management agreements.
- 7. Section 8.1 to approve selection or termination of the auditor.
- 8. Section 10.2 to remove the general partner for cause if the general partner fails to fulfill any of the other agreements between the partners involving this same transaction or the failure of the project to meet the requirements of section 42 or to maintain at least a 90 percent occupancy level.
- 9. Section 10.3 to remove the general partner without cause.
- 10. Sections 11.2 and 14.3 to dissolve and terminate the partnership.

The partnership agreement provides additional protections for the limited partner. For example, the capital contributions made by the limited partner were made in installments which became due only after various contingencies had been satisfied. Such contingencies included satisfaction of the guaranty agreements.

The partnership agreement also notes that the general partner has entered into various other agreements which place

obligations on the general partner in its corporate capacity rather than its capacity as a general partner.

The completion guaranty agreement provided that you guarantee all costs over a stated amount and that the project would be completed by a certain date. If the project was not completed by that date, did not provide credits in the year placed in service or the following year, or did not provide a rehabilitation credit you would have had to acquire the entire interest of the limited partner plus interest.

The lease-up guaranty agreement provided that you would guarantee that if the project is not specified date you would have been required to return the capital contribution of the limited partner.

The tax credit guaranty agreement provides that if the tax credit is less than a specified amount in any year, you guarantee to pay the reduction amount. If the credit reduction is permanent, then you guarantee payment of percent of the total reduction for the remaining compliance period within days. In addition, if the allocation is less than anticipated, you guarantee a payment of percent of any reduction amount within days of the allocation. Furthermore, if any credit is recaptured, you guarantee the amount of the credit plus interest and penalties.

Sections 501(a) and 501(c)(3) of the Code provide, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that to be exempt under section 501(c)(3) of the Code an organization must be organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(1) of the regulations provides, in part, that an organization may be exempt under section 501(c)(3) of the Code if it is organized for charitable purposes. However, it is not organized or operated exclusively for a charitable purpose unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of designated individuals.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" in its generally accepted legal sense and it is not limited by the separate enumeration of exempt purposes in section 501(c)(3) of the Code. The term includes, inter alia, relief of the poor and distressed.

Rev. Proc. 96-32, 1996-20 I.R.B. 14, provides that an organization will be considered to relieve the poor and distressed if it establishes that 75 percent of the units are occupied by residents that qualify as low-income and that either (a) 20 percent of the units are occupied by very low-income residents or (b) 40 percent of the units are occupied by residents that do not exceed 120 percent of the area's very low-income limit. In addition, the units must be affordable to the residents. This will ordinarily be satisfied by adopting a government-imposed rent restriction.

Plumstead Theatre Society. Inc. v. Commissioner. 74 T.C. 1324 (1980), 675 F.2d 244 (9th Cir. 1982) holds that an organization's participation as a general partner in a limited partnership would not adversely affect its tax-exempt status under sections 501(a) and 501(c)(3) of the Code where pursuant to an arm's length transaction, the charitable general partners sold two-thirds of its half interest in the play to three limited partners. Important to the holding is that the general partner was not obligated to return capital to the investors out of its own funds and that the limited partners have no control over the way the organization manages its affairs and that none of the limited partners are directors or officers of the general partner. The opinion concludes that an interest in a single play is not intrusive or indicative of serving private interests.

Housing Pioneers, Inc. v. Commissioner, T.C.M. 1993-120, aff'd 58 F.3d 401 (9th Cir. 1995) holds that an organization's participation as a general partner in a limited partnership precludes exemption where the investors privately benefit from the arrangement. The opinion notes that section 501(c)(3) of the Code controls the exemption issue. It also notes that Plumstead Theatre Society, Inc. does not apply because factually it differs from the instant case, because private benefit issues were raised when two of limited partners were also board members of the general partner applying for tax-exemption.

Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U. S. 279 (1945), holds that an organization that educates the public and local businesses about honest business practices has a purpose to advance the members' business as well as a purpose to educate the public. Thus, when an organization carries out a nonexempt purpose, substantial in nature, it will destroy the exemption regardless of the number and importance of the truly exempt purposes.

Because the owner of the project, the partnership, satisfies the residency requirements and the rent restrictions imposed pursuant to an allocation of low-income housing tax-credits, you, as managing partner, may claim that you satisfy section 3 of Rev.

Proc. 96-32 provided that you can demonstrate that as general partner you cause the partnership to satisfy the safe harbor. Because there is nothing in the agreements that would enable the limited partners to prevent you from carrying out the occupancy and rental restriction requirements, we conclude that you relieve the poor and distressed because you satisfy the safe harbor. However, whether you qualify for exemption depends on whether you also do not provide a private benefit for the limited partners.

As demonstrated in <u>Better Business Bureau of Washington</u>.

D.C., Inc. a single function may actually achieve more than one purpose. If one purpose is nonexempt and substantial in nature it destroys the exemption regardless of the number and importance of the exempt purposes. Thus, regardless of the fact that you may cause the partnership to provide housing to persons regarded as poor and distressed, you will not qualify for exemption if a substantial purpose of yours is to benefit the limited partners.

In this regard, <u>Plumstead Theatre Society</u>. <u>Inc.</u> provides guidance. In that case, the general partner was not obligated to return capital out of its own funds, the limited partners had no control over the general partner in the management of its affairs and the none of the limited partners are directors or officers of the general partner. In sum, the limited partnership did not intrude into the exempt operations.

In your case, you have but a single function which is to manage a limited partnership that will develop and operate low-income housing. Thus, controls that the limited partners have over the creation or operation of the partnership will necessarily detract from your exempt operation. Many controls that the limited partners have under the agreement may be neutral in effect. For example, if the limited partners can require you to provide them with information may not cause you to operate in a nonexempt manner. However, controls that may enforce nonexempt functions are inherently intrusive.

Other controls that the limited partners have may demonstrate that certain penalty or quaranty provisions are intrusive.

your obligation to acquire the interest of the limited partner in the completion guaranty agreement, your obligation to return capital in the lease-up guaranty agreement or your payment of percent of any permanent reduction amount in the tax credit guaranty agreement are all forms of return of capital to the limited partners from your own funds which is directly contrary to the holding in <u>Plumstead Theatre Society</u>. Inc. In addition, the tax credit guaranty agreement provides the further obligation to pay a credit reduction in any year or to pay the credit plus penalties and interest for any recapture of the tax-credits.

This is beyond an obligation to return capital. Rather, it obligates you to pay the anticipated investment return.

Under these provisions, you are an indemnifier of the limited partner's investment which is a substantial nonexempt purpose. Furthermore, the limited partner's enforcement of these nonexempt functions intrudes into your management of your own affairs. The limited partner can remove you with or without cause. If it is with cause, the limited partner may unilaterally retain your interests in the partnership.

Your operation as an indemnifier of the limited partner is further reflected in the limited partner's control over the operations. Where the limited partner approves the builder, the manager, approves the contracts as well as other controls and where the guaranty agreements place the ultimate obligation on you, you operate to indemnify the limited partner.

Although Plumstead Theatre Society, Inc. may permit a charitable organization's operation as a general partner in limited partnerships when specified conditions exist, Housing Pioneers, Inc. makes it clear that when an organization fails one of the conditions of Plumstead, that organization cannot rely on that case to establish its qualification for exemption.

In addition, you operate a single housing project in which the limited partners have control over rehabilitation construction and the selection of professionals and tradesmen. Your situation is by its very nature more intrusive than the facts described in the <u>Plumstead</u> case to fail section 7 of Rev. Proc. 96-32 and precludes your qualification for recognition of exemption, notwithstanding your satisfaction of the safe harbor in section 3 of Rev. Proc. 96-32. Accordingly, we conclude that you are not operated exclusively for charitable purposes as required in section 1.501(c)(3)-1(d)(1) of the regulations.

Because you are an organization formed, in part, to benefit the limited partners, we conclude that you are organized and operated for the private benefit of your partners. Therefore, you are not described in section 501(c)(3) of the Code and are not exempt under section 501(a). Contributions to you are not deductible under section 170 of the Code. You are required to file federal income tax returns on Form 1120.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days from today and must be signed by one of your principal officers. When sending a protest or other

correspondence with respect to this case, you will expedite its receipt by placing the following symbols on the envelope: CP:E:EO:T:5 Room 6539. These symbols do not refer to your case, but rather to its location.

You also have the right to a conference in this office after your protest statement is submitted. If you desire a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceedings unless the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director for your key district. Thereafter, any questions about your federal income tax status should be addressed to your District Director. The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely,

(eigned) Garland A. Carter

Garland A. Carter Chief, Exempt Organizations Rulings Branch 5

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